Coronavirus is breaking the supply chains in the Eurozone

This week

- **Important data from the US will be released this week**. The second estimate of GDP in Q4 will be released on Thursday. We expect that the annualized economic growth rate has been revised upwards to 2.2% vs. 2.1% in the flash estimate, due to a higher contribution of private consumption. On Thursday we will also see data on durable goods orders. In our view, their dynamics dropped to 0.3% MoM in January vs. 2.4% in December, due to high base effect. The improvement of consumer sentiment will be indicated by the Conference Board Index (132.0 pts in February vs. 131.6 pts in January) and the final University of Michigan Index (100.9 pts vs. 99.8 pts in January). We expect that, like in the case of the preliminary University of Michigan Index, the concerns surrounding the coronavirus outbreak in China, will not contribute towards deteriorating consumer sentiment. The data on the US economy will be overshadowed by the incoming information about the spread of the coronavirus epidemic and the comments by FED representatives on the outlook for the US monetary policy.
- **On Friday GUS will publish full data on GDP in Q4 2019.** We expect that the economic growth rate was in line with the flash estimate and amounted to 3.1% YoY vs. 3.9% in Q3. The GDP data will be relevant to assessing the scale of the deceleration of consumption growth but their publication should not be market moving.
- **Ifo Index reflecting the sentiment among German managers representing the manufacturing, construction, trade and services sectors was released today.** The index increased to 96,1 pts vs 95,9 pts in January.

Last week

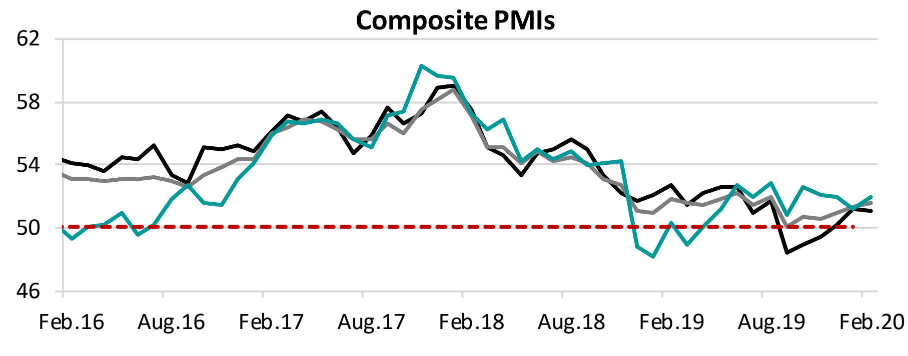
- **In accordance with flash data, the composite PMI (for manufacturing and services sector) in the Eurozone rose to 51.6 pts in February vs. 51.3 pts in January, running above the market expectations (51.0 pts).** Thus, the index has reached the highest level since August 2019. The index increase resulted from higher values of the sub-indices for both output in manufacturing and business activity in services. The average PMI value between January and February (51.5 pts) stood above the average for Q4 (50.7 pts), thus posing an upside risk to our forecast, in which the quarterly GDP growth rate in the Eurozone has not changed in Q1 compared to Q4 and amounted to 0.1% (see below).
- **Retail sales in Poland increased in current prices by 5.7% YoY in January vs. a 7.5% increase in December**. The sales dynamics in constant prices decreased to 3.4% in January vs. 5.7% in December. The decrease in real retail sales growth rate in January was largely due to the statistical effect in the form of an unfavourable difference in the number of working days and to higher inflation in January. We are of the opinion that the deteriorating consumer sentiment is going to limit retail sales dynamics in subsequent months. The weakening of consumer demand is already visible in the category “furniture, audio-video and household equipment” (see MACROpulse of 21/2/2020). Consequently, we see a downside risk to our forecast assuming that the annual consumption dynamics will stabilize in Q1 at the Q4 level (3.4%).
- **The dynamics of industrial production in Poland decreased to 1.1% YoY in January vs. 3.8% in December.** The main factor behind the decrease in the industrial production dynamics between December and January was an unfavourable difference in the number of working days. However, the scale of the production slowdown in January was smaller than it would result from the unfavourable calendar effects. We believe that it may have resulted from the distribution of holidays in December 2019 which encouraged longer leaves of absence, limiting production at the time and boosting its dynamics in January. Especially noteworthy in the data structure is high output dynamics in branches responsible for the supply of raw materials and consumables used in construction projects. This is a surprise in the light of the ending cycle in

public investments and, in our view, may be linked to a relatively warm winter this year, which supported construction works (see MACROpulse of 20/2/2020). The export-oriented branches also recorded relatively high dynamics. This points to the continuing resilience of the Polish manufacturing to the slowdown of economic growth in Poland's major trade partners (Germany and the Eurozone), contributing to a marked decrease in demand for Polish exports (see below). The data on industrial production pose an upside risk to our forecast of economic growth in Q1 (3.0% YoY vs. 3.1% in Q4 2019).

- **The construction-assembly production increased by 6.5% YoY in January vs. a 3.3% decline in December**. The increase in the annual dynamics of construction-assembly production was recorded in all its categories. Seasonally-adjusted construction-assembly production increased by 9.4% MoM vs. a 3.5% decline in December. The construction-assembly production has sharply increased despite the statistical effect in the form of an unfavourable difference in the number of working days and the recently observed end of cycle in public investments. Consequently, we believe that this increase is temporary and, to a significant extent, results from the exceptionally mild winter, which supported the conduct of construction works. (see MACROpulse of 21/2/2020). The data on construction-assembly production do not alter our forecast in which the dynamics of the Polish GDP will decrease to 3.0% YoY in Q1 vs. 3.1%.
- **Nominal wage dynamics in the Polish sector of enterprises increased to 7.1% YoY in January vs. 6.2% in December 2019.** The significant acceleration in wage growth in January resulted from a higher-than-last year increase in the minimum pay (see MACROmap of 19/2/2020). Wage dynamics in the sector of enterprises amounted to 1.1% YoY in January vs. 2.6% in December. In MoM terms, employment increased by 44.9k. The sharp increase in MoM employment resulted from the annual review of data on employment in microenterprises (employing up to 9 persons). The increase in employment in January 2020 was visibly lower from last year (it then amounted to 135.7k), being conducive to decreasing its annual dynamics. The smaller scale of the review is consistent with the currently observed deceleration of the improvement in the labour market. We estimate that the real wage fund growth rate (the employment times the average salary) in enterprises amounted to 3.8% YoY in January vs. 5.5% in December 2019 and 5.6% in Q4 2019. Due to the aforementioned review of data on employment in microenterprises, the data on real wage fund dynamics in December 2019 and January 2020 are not fully comparable. The last week's data are consistent with our scenario assuming stabilization of consumption dynamics in Q4 2019 and Q1 2020 (3.4% YoY).
- **Important data from the US were released last week.** The data on building permits (1551k in January vs. 1420k in December), housing starts (1567k vs. 1626k), and existing home sales (5.46M vs. 5.54M) indicated high activity in the US real estate market. In turn, NY FED and Philadelphia FED indices signaled improvement in manufacturing. The last week's data do not alter our forecast, in which the annualized US GDP growth rate will decrease to 1.6% in Q1 vs. 2.2% in Q4.
- **The Minutes of the January FOMC meeting were released last week.** As we expected, the document has brought no substantial new information compared to the FED Chairman's testimony to the Congress three weeks ago, especially in the context of assessing the impact of the coronavirus outbreak on the US economy (see MACROmap of 17/2/2020). The scale of the epidemic has significantly increased since the last FOMC meeting; therefore, it is highly likely that some views included in the Minutes are no longer valid. Noteworthy in the description of the discussion is a slightly better assessment of the outlook for investments, due to the preliminary trade agreement between the US and China. Our baseline scenario assumes that FED will cut interest rates by 25 bp in Q2 2020 in reaction to the expected by us slowdown of economic growth.
- **ZEW index reflecting the sentiment among analysts and institutional investors regarding the economic situation in Germany dropped to 8.7 pts in February vs. 26.7 pts in January, running significantly below the market expectations (21.5 pts)**. According to the statement, the main

reason for the index decline were survey participants' concerns about the impact of coronavirus outbreak in China on global trade. The recently published weaker-than-expected data from the German economy were also negative for the survey participants' sentiment. However, in the light of the global coronavirus epidemic, we see a substantial downside risk to our forecast, in which the quarterly dynamics of the Germane GDP will increase to 0.3% in Q1 vs. 0.0% in Q4.

Coronavirus is breaking the supply chains in the Eurozone



Source: Markit, Credit Agricole

According to flash data, the Composite PMI (for manufacturing and the services sector) in the Eurozone rose to 51.6 pts in February vs. 51.3 pts in January, running above the market expectations (51.0 pts). Thus, the index has reached the highest level since August 2019. The increase of the Composite PMI resulted from higher values of the sub-indices for both output in manufacturing and business activity in services. The average PMI value between January and February (51.5 pts) stood above the average for Q4 (50.7 pts), thus posing an upside risk to our forecast, in which the quarterly GDP growth rate in the Eurozone has not changed in Q1 compared to Q4 and amounted to 0.1%.The estimated by Markit (exclusively on the basis of PMI values) economic growth rate amounts to 0.2% QoQ in Q1.

At first glance, the business survey results present a moderately favourable picture of activity in the Eurozone. However, an in-depth analysis points to deterioration in manufacturing, despite the index increase recorded for this sector (49.1 pts in February vs. 47.9 pts in January). This increase results from the way in which PMI is structured. One of its sub-indices illustrates the suppliers' delivery times. Longer delivery times reported by companies are conducive to an increase of the main index, i.e. to improvement of business sentiment. Such approach is usually correct, assuming that delays in deliveries result from stronger demand for goods. In turn, shorter delivery times signaling weaker demand, in the intention of the authors of the survey, result in PMI decrease.

The February data show longer delivery times caused not by higher demand but by so-called supply shock. Most companies reporting delays in deliveries (the longest since December 2018) pointed out the disturbances in the supply chains resulting from the COVID-19 outbreak in China. Thus, due to the index structure, the negative impact of the epidemic on the economic activity in the Eurozone has not been reflected correctly as it has in fact contributed to PMI increase. Assuming that the delivery times' indicator had not changed between January and February, the manufacturing PMI for the Eurozone would have been 0.7 pts lower than it actually was (namely it would be 0.5 pts higher than in January and 0.9 pts higher from the market expectations).

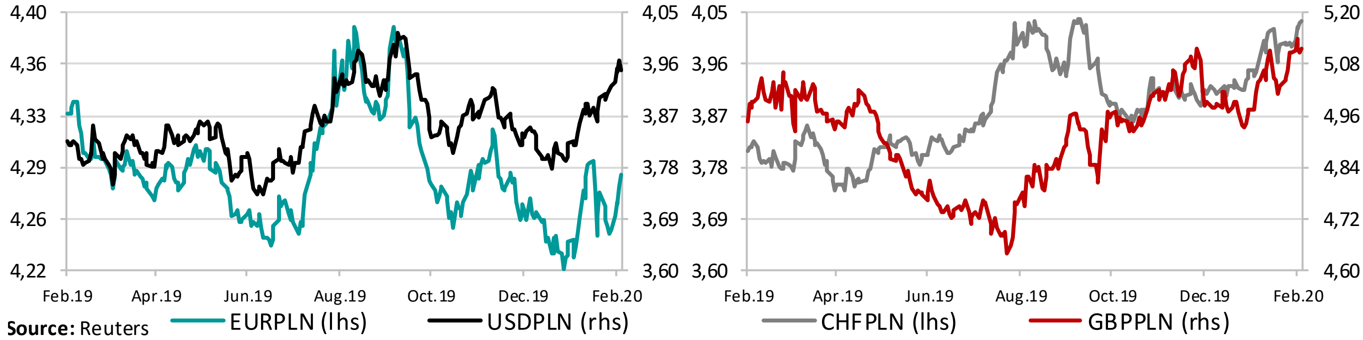
At the same time, it should be pointed out that apart from the delays in delivery times resulting from disruptions in supply chains, the coronavirus epidemic in China has so far had a limited impact on the manufacturing activity in the Eurozone. The sub-indices for employment, total new orders, and output stood at higher levels than in January. The only pessimistic area of the results of the business survey for the Eurozone manufacturing is a deepening decline in new export orders. However, it is impossible to unequivocally determine to what extent it is attributable to lower demand from non-Eurozone countries (e.g. from China) or to lower foreign trade between the individual Eurozone countries.

From the point of view of the outlook for Polish exports, the sentiment in the German manufacturing is of particular importance. Like in the case of the whole Eurozone, the German index pointed to a seemingly improved sentiment – it rose to 47.8 pts in February from 45.3 pts in January. The index structure is also similar to that for the whole Eurozone. The sub-indices for employment, total new orders, and output stood at higher levels than in January and delays were recorded in delivery times. Assuming that the delivery times' indicator had not changed between January and February, the manufacturing PMI for Germany would have been 1.2 pts lower from what it actually was (namely it would be still 1.3 pts higher from January and 1.8 pts higher from the market expectations). Most likely, the impact of the coronavirus outbreak was stronger in Germany than in the whole Eurozone. This view is supported by information in the Markit report, according to which some German companies had to limit production due to insufficient stocks of component parts used in the production process.

We expect that the disruptions in the supply chains between China and the Eurozone (Germany, in particular) will intensify in the coming months. Due to the way in which the PMI index is structured, it will be only partly reflected by its value. Only substantial shortages of goods used in the production of final goods (so-called intermediate goods), leading to a marked decline in output, will be visible in a decrease of the main PMI index. If such scenario materializes, we are likely to see a weakening of demand from Germany for the intermediate goods made in Poland. This will be conducive to the slowdown of economic growth in Poland in 2020. In the next MACROmap we will present an analysis of the sensitivity of Poland and of other countries of the region to the disturbances in the chains of supply from China.

Foreign exchange market impacted by reports on coronavirus epidemic

FX rates



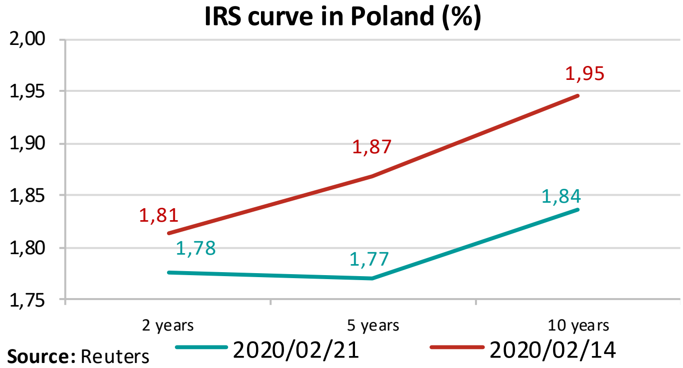
Source: Reuters

Last week, the EURPLN exchange rate rose to 4.2864 (weakening of PLN by 0.9%). Last week, like in previous weeks, the situation on the foreign exchange market continued to be impacted by the investors' sentiment shaped by media reports on the coronavirus epidemic. The information which prevailed last week indicated that the epidemic had not yet been brought under control and the virus was still highly likely to be spreading further. This supported investors' concerns about the impact of coronavirus on the global economic outlook. Consequently, throughout last week we saw the depreciation of PLN and of other emerging currencies. Numerous publications of domestic data and of business survey results for the Eurozone were not market moving.

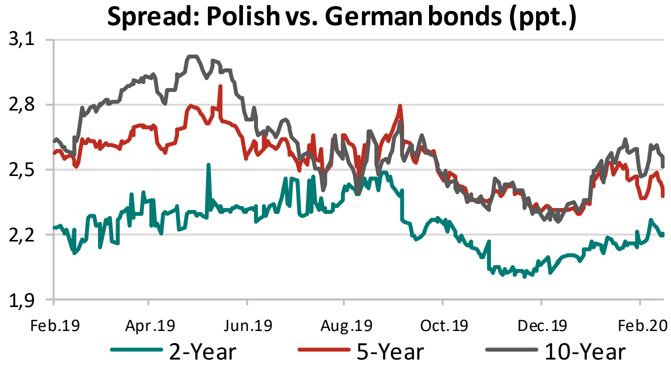
Last week also saw further depreciation of EUR vs. USD. EURUSD decrease was supported by both the aforementioned increased risk aversion resulting from the coronavirus epidemic and by investors' concerns about the economic outlook for the Eurozone. For the same reasons, EUR was also depreciating vs. CHF. However, Friday saw a correction and EURUSD increase in reaction to clearly weaker-than-expected PMIs for the USA.

Crucial for PLN this week will be the media reports on the coronavirus epidemic. We believe that the aggregate impact of the data from the US (second estimate of GDP, Conference Board Index, and final University of Michigan Index) on PLN will be limited. In our view, the final estimate of the Polish GDP will also be neutral for PLN.

IRS highly volatile due to coronavirus epidemic



Source: Reuters



Last week, 2-year IRS rates decreased to 1.78 (down by 3bp), 5-year rates to 1.78 (down by 8bp), and 10-year rates to 1.77 (down by 11bp). Last week IRS rates plummeted following the core markets. This was largely due to the intensification of concerns about the global economic outlook owing to the coronavirus epidemic. This view is supported by the increase in the expectations of interest rate cuts in the US. The market is now pricing in a 50bp cut by FED before the end of the year (25bp in June and 25bp in December). Both the publications of numerous domestic data and flash PMIs for the Eurozone had a limited impact on the market. On Thursday there was a debt exchange auction at which the Ministry of Finance repurchased PLN 4.1bn of bonds maturing in 2020 and 2021 and sold the same amount of 2-, 4-, 5-, 9- and 27-year bonds with demand amounting to PLN 5.1bn. The auction had no significant impact on the curve.

This week the market will focus on media reports about the coronavirus epidemic. In our view, the final estimate of the Polish GDP will not be market moving. The data from the US (second estimate of GDP, Conference Board Index, and final University of Michigan Index) will also be neutral for the curve.

Forecasts of the monthly macroeconomic indicators

Main monthly macroeconomic indicators in Poland														
Indicator	**Jan.19**	**Feb.19**	**Mar.19**	**Apr.19**	**May.19**	**Jun.19**	**Jul.19**	**Aug.19**	**Sep.19**	**Oct.19**	**Nov.19**	**Dec.19**	**Jan.20**	**Feb.20**
NBP reference rate (%)	1,50	1,50	1,50	1,50	1,50	1,50	1,50	1,50	1,50	1,50	1,50	1,50	1,50	1,50
EURPLN*	4,26	4,30	4,30	4,28	4,28	4,24	4,29	4,38	4,37	4,26	4,31	4,26	4,30	**4,27**
USDPLN*	3,72	3,79	3,84	3,82	3,83	3,73	3,87	3,98	4,01	3,82	3,91	3,79	3,87	**3,85**
CHFPLN*	3,74	3,79	3,85	3,75	3,83	3,82	3,90	4,02	4,02	3,87	3,91	3,92	4,02	**3,97**
CPI inflation (% YoY)	0,7	1,2	1,7	2,2	2,4	2,6	2,9	2,9	2,6	2,5	2,6	3,4	4,4	
Core inflation (% YoY)	0,8	1,0	1,4	1,7	1,7	1,9	2,2	2,2	2,4	2,4	2,6	3,1	**3,3**	
Industrial production (% YoY)	6,0	6,9	5,5	9,2	7,6	-2,6	5,8	-1,5	5,5	3,7	1,5	3,8	1,1	
PPI inflation (% YoY)	2,2	2,9	2,5	2,6	1,4	0,5	0,5	0,9	0,8	-0,3	-0,1	1,0	0,8	
Retail sales (% YoY)	6,6	6,5	3,1	13,6	7,3	5,3	7,4	6,0	5,3	5,4	5,9	7,5	5,7	
Corporate sector wages (% YoY)	7,5	7,6	5,7	7,1	7,7	5,3	7,4	6,8	6,6	5,9	5,3	6,2	7,1	
Employment (% YoY)	2,9	2,9	3,0	2,9	2,7	2,8	2,7	2,6	2,6	2,5	2,6	2,6	1,1	
Unemployment rate* (%)	6,1	6,1	5,9	5,6	5,4	5,3	5,2	5,2	5,1	5,0	5,1	5,2	**5,5**	
Current account (M EUR)	2529	-630	217	542	430	-114	-915	-246	962	573	1564	990		
Exports (% YoY EUR)	5,9	10,5	7,8	9,6	11,5	-2,6	5,9	-1,8	13,5	3,8	-0,2	10,6		
Imports (% YoY EUR)	2,1	8,4	2,8	8,0	11,1	-5,4	6,9	-3,4	6,4	-0,2	-4,1	0,8		

*end of period

Forecasts of the quarterly macroeconomic indicators

Main macroeconomic indicators in Poland											
Indicator	**2019**				**2020**				**2019**	**2020**	**2021**
	Q1	**Q2**	**Q3**	**Q4**	**Q1**	**Q2**	**Q3**	**Q4**			
Gross Domestic Product (% YoY)	4,8	4,6	3,9	3,1	3,0	2,9	2,7	2,4	4,0	2,7	3,3
Private consumption (% YoY)	3,9	4,4	3,9	3,4	3,4	3,3	3,1	3,0	3,9	3,2	2,8
Gross fixed capital formation (% YoY)	12,2	9,1	4,7	7,2	3,9	2,2	0,8	-1,8	7,8	0,7	3,5
Export - constant prices (% YoY)	7,3	3,2	5,0	4,0	3,5	3,6	4,2	4,4	4,8	3,9	5,0
Import - constant prices (% YoY)	6,0	3,1	3,9	5,2	3,8	3,4	2,9	2,3	4,5	3,1	4,0
GDP growth contributions: Private consumption (pp)	2,5	2,5	2,2	1,7	2,1	1,9	1,8	1,5	2,2	1,8	1,6
GDP growth contributions: Investments (pp)	1,5	1,5	0,8	1,8	0,5	0,4	0,1	-0,5	1,4	0,1	0,6
GDP growth contributions: Net exports (pp)	1,0	0,2	0,8	-0,5	0,0	0,3	0,8	1,2	0,4	0,6	0,8
Current account (% of GDP)***	-0,6	-0,4	0,2	1,1	0,4	0,3	0,2	0,1	1,1	0,1	-0,2
Unemployment rate (%)**	5,9	5,3	5,1	5,2	5,5	5,0	5,0	5,3	5,2	5,3	5,5
Non-agricultural employment (% YoY)	0,0	0,2	0,5	0,1	-0,1	-0,1	-0,2	-0,3	0,2	-0,2	-0,5
Wages in national economy (% YoY)	7,1	7,0	7,7	6,9	7,5	7,6	7,4	7,0	7,2	7,4	6,0
CPI Inflation (% YoY)*	1,2	2,4	2,8	2,8	4,2	3,4	2,8	2,5	2,3	3,2	1,6
Wibor 3M (%)**	1,72	1,72	1,72	1,71	1,71	1,71	1,71	1,71	1,71	1,71	1,71
NBP reference rate (%)**	1,50	1,50	1,50	1,50	1,50	1,50	1,50	1,50	1,50	1,50	1,50
EURPLN**	4,30	4,24	4,37	4,26	4,29	4,29	4,29	4,29	4,26	4,29	4,25
USDPLN**	3,84	3,73	4,01	3,79	3,90	3,83	3,76	3,80	3,79	3,80	3,83

* quarterly average
** end of period
***cumulative for the last 4 quarters

Calendar

TIME	COUNTRY	INDICATOR	PERIOD	PREV. VALUE	FORECAST* CA	FORECAST* CONSENSUS**
		Monday 02/24/2020				
10:00	Germany	Ifo busienss climate (pts)	Feb	95,9	95,5	95,1
14:00	**Poland**	**M3 money supply (%YoY)**	**Jan**	**8,3**	**8,6**	**8,8**
		Tuesday 02/25/2020				
8:00	Germany	Final GDP (% QoQ)	Q4	0,0	0,0	0,0
10:00	**Poland**	**Registered unemplyment rate (%)**	**Jan**	**5,2**	**5,5**	**5,5**
15:00	USA	Case-Shiller Index (% MoM)	Dec	0,5		0,5
16:00	USA	Richmond Fed Index	Feb	20,0		
16:00	USA	Consumer Confidence Index	Feb	131,6	132,0	132,0
		Wednesday 02/26/2020				
16:00	USA	New home sales (k)	Jan	694	715	705
		Thursday 02/27/2020				
10:00	Eurozone	M3 money supply (% MoM)	Jan	5,0		5,3
11:00	Eurozone	Business Climate Indicator (pts)	Feb	-0,23		
14:30	USA	Second estimate of GDP (% YoY)	Q4	2,1	2,2	2,1
14:30	USA	Durable goods orders (% MoM)	Jan	2,4	0,3	-1,5
		Friday 02/28/2020				
14:00	Germany	Preliminary HICP (% YoY)	Feb	1,6	1,6	1,5
14:30	USA	Real private consumption (% MoM)	Jan	0,1		
15:45	USA	Chicago PMI (pts)	Feb	42,9		45,3
16:00	USA	Final U. of Michigan Sentiment Index (pts)	Feb	100,9	100,9	100,9

*The forecasts of macroeconomic indicators for Poland were prepared by Credit Agricole Bank Polska S.A. The forecasts of foreign indicators were prepared by Crédit Agricole Corporate and Investment Bank
** Reuters

Jakub BOROWSKI
Chief Economist
tel.: 22 573 18 40
jakub.borowski@credit-agricole.pl

Krystian JAWORSKI
Senior Economist
tel.: 22 573 18 41
krystian.jaworski@credit-agricole.pl

Jakub OLIPRA
Economist
tel.: 22 573 18 42
jakub.olipra@credit-agricole.pl